Understanding the difference between a 1035 Exchange and a SPIA

A 1035 exchange and a Single Premium Immediate Annuity (SPIA) are not competing products, but rather related financial concepts that can be used together. A 1035 exchange is a tax-free transfer of funds from one insurance or annuity contract to another, and a SPIA is a type of annuity contract that can be purchased with those funds.

1035 Exchange

A 1035 exchange is a provision under Section 1035 of the Internal Revenue Code that allows you to transfer funds tax-free from one insurance contract to another "like-kind" contract.

- **Purpose**: To upgrade an outdated or underperforming policy, consolidate multiple policies, or change the type of contract to better align with your financial goals.
- **Process**: The funds must be transferred directly from the old insurance company to the new one. You cannot cash out the funds and then purchase a new policy, as that would trigger a taxable event.
- **Allowable exchanges**:
    - Annuity to annuity (including a SPIA)
    - Life insurance to life insurance
    - Life insurance to an annuity (including a SPIA)
- **Limitations**:
    - The owner of the contracts must remain the same.
    - You may face surrender charges from your original insurance company.
    - Exchanging a variable annuity for a new one can result in the loss of valuable guarantees from the original contract.

Single Premium Immediate Annuity (SPIA)

A SPIA is a contract you purchase with a single, one-time lump-sum payment. The insurance company then converts this sum into a guaranteed, immediate income stream that starts within one year of purchase.

- **Purpose**: To turn a portion of your retirement savings into a predictable "paycheck" that provides guaranteed income for life or a specific period.

- **Funding**: A SPIA is typically purchased by retirees using a lump sum from savings, a life insurance policy's cash value, or a deferred annuity via a 1035 exchange.
- **Customization**: You can customize your payout options to receive income for a fixed period (period certain), for the rest of your life (single life), or for the life of you and your spouse (joint life).
- **Trade-off**: Because you are converting a lump sum into a future income stream, a SPIA is generally illiquid. Once purchased, you lose access to the original principal.

How they can work together

A 1035 exchange can be the mechanism you use to move the money needed to purchase a SPIA. This strategy is most useful if you have an underperforming or unwanted policy.

Example scenario

1. **You own a deferred annuity** that has grown in value but now has high fees or uncompetitive rates. You are nearing retirement and want to turn this asset into a reliable income stream.
2. **You initiate a 1035 exchange** to move the tax-deferred cash value from the old deferred annuity directly to a new insurance company.
3. **You use the exchanged funds to purchase a SPIA** from the new company, which immediately begins paying you a guaranteed stream of income.

This process allows you to upgrade your contract while deferring taxes on the gains, and ultimately reposition your asset to provide a guaranteed income stream.

For more information contact: